

## Internal Revenue Service

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Department of the Treasury  
Washington, DC 20224

Person To Contact:

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PLR-114153-06

Date: March 12, 2007

X =

Y =

A =

B =

C =

D =

State =

Trust 1 =

Trust 2 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Dear :

This responds to a letter dated February 15, 2006, and subsequent correspondence, submitted on behalf of X, Trust 1, and Trust 2 by their authorized representative, requesting relief under Section 1362(f) of the Internal Revenue Code (the "Code") for inadvertent termination of an S corporation election and an extension of time pursuant to § 301.9100-3 of the Procedure and Administration Regulations to make elections under § 1361(d)(2).

#### FACTS

The information submitted states that X was incorporated under the laws of State on Date 1 and elected to be treated as an S corporation, effective Date 2. Trust 1, a grantor trust that was treated (under subpart E of part 1 of subchapter J of chapter 1) as entirely owned by A, was a shareholder of X. Trust 2, a grantor trust that was treated (under subpart E of part 1 of subchapter J of chapter 1) as entirely owned by C, was also a shareholder of X.

On Date 3, A died. Trust 1 became irrevocable and ceased to be a grantor trust. Trust 1 continued to qualify as a permissible S corporation shareholder under § 1361(c)(2)(A)(ii) for the 2-year period beginning on Date 3 and ending on Date 4.

On Date 5, C died. Trust 2 became irrevocable and ceased to be a grantor trust. Trust 2 continued to qualify as a permissible S corporation shareholder under § 1361(c)(2)(A)(ii) for the 2-year period beginning on Date 5 and ending on Date 6.

Under the terms of Trust 1, the sole beneficiary of Trust 1 was B. X represents that Trust 1 is qualified to be treated as a qualified subchapter S trust (QSST) described in § 1361(d)(1), except that B failed to make the election under § 1361(d)(2). Therefore,

Trust 1 ceased to be an eligible S corporation shareholder on Date 4, and X's S corporation election terminated on Date 4.

Under the terms of Trust 2, the sole beneficiary of Trust 2 was D. X represents that Trust 2 is qualified to be treated as a qualified subchapter S trust (QSST) described in § 1361(d)(1), except that D failed to make the election under § 1361(d)(2). Therefore, Trust 2 ceased to be an eligible S corporation shareholder on Date 6, and – had X's S corporation election not terminated on Date 4 – X's S corporation election would have terminated on Date 6.

On Date 7, Y acquired X in a transaction qualifying as a reorganization under § 368(a)(1)(B). Y elected to be treated as an S corporation, as well as to treat X as a Qualified Subchapter S Subsidiary, each effective Date 7.

Since Date 3, X and its shareholders have filed income tax returns consistent with the treatment of X as an S corporation and Trust 1 and Trust 2 as QSSTs described in § 1361(d)(1).

X represents that the circumstances resulting in the termination of X's S corporation election were inadvertent and were not motivated by tax avoidance or retroactive tax planning. X and its shareholders have agreed to make such adjustments (consistent with the treatment of X as an S corporation) as may be required by the Secretary.

## LAW AND ANALYSIS

Section 1362(a) provides that, except as provided in § 1362(g), a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1)(B) provides that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Section 1361(c)(2)(A)(i) provides that for purposes of § 1361(b)(1)(B), a trust, all of which is treated (under subpart E of part I of subchapter J of Chapter 1) as owned by an individual who is a citizen or resident of the United States, may be an S corporation shareholder.

Section 1361(c)(2)(A)(iii) provides that a trust, with respect to stock transferred to it pursuant to the terms of a will, but only for the two-year period beginning on the day on which such stock is transferred to it, may be a shareholder in an S corporation.

Section 1361(d)(1) provides that in the case of a QSST with respect to which a beneficiary makes an election under § 1361(d)(2): (A) such trust shall be treated as a trust described in § 1361(c)(2)(A)(i); and (B) for purposes of § 678(a), the beneficiary of such trust shall be treated as the owner of that portion of the trust which consists of stock in an S corporation with respect to which the election under § 1361(d)(2) is made.

Section 1361(d)(2)(A) provides that a beneficiary of a QSST (or his legal representative) may elect to have § 1361(d) apply. Section 1361(d)(2)(D) provides that an election under § 1361(d)(2) shall be effective up to 15 days and 2 months before the date of the election.

Section 1361(d)(3) defines a QSST as a trust (A) the terms of which require that (i) during the life of the current income beneficiary, there shall be only one income beneficiary of the trust; (ii) any corpus distributed during the life of the current income beneficiary may be distributed only to such beneficiary; (iii) the income interest of the current beneficiary in the trust shall terminate on the earlier of the beneficiary's death or the termination of the trust; and (iv) upon the termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to that beneficiary; and (B) all of the income (within the meaning of § 643(b)) of which is distributed (or required to be distributed) currently to one individual who is a citizen or resident of the United States.

Section 1.1361-1(j)(6)(ii) of the Income Tax Regulations provides that the current income beneficiary of the trust must make the election under § 1361(d)(2) by signing and filing with the service center with which the corporation files its income tax return the applicable form or a statement including the information listed in § 1.1361-1(j)(6)(ii).

Section 1362(d)(2)(A) provides that an election under § 1362(a) will be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(d)(2)(B) provides that the termination shall be effective on and after the date of cessation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation (A) was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents, or (B) was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in such

ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness or termination, steps were taken (A) so that the corporation is a small business corporation, or (B) to acquire the required shareholder consents, and (4) the corporation, and each person who was a shareholder in the corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such ineffectiveness or termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 301.9100-1(c) provides that the Commissioner may grant a reasonable extension of time to make a regulatory election, or a statutory election (but no more than six months except in the case of a taxpayer who is abroad), under all subtitles of the Code, except E, G, H, and I. Requests for relief under § 301.9100-3 will be granted when the taxpayer provides evidence to establish that the taxpayer acted reasonably and in good faith, and that granting relief will not prejudice the interests of the government. Section 301.9100-3(a). Section 301.9100-1(b) defines a regulatory election to include an election whose due date is prescribed by a regulation published in the Federal Register, or a revenue ruling, revenue procedure, notice, or announcement published in the Internal Revenue Bulletin.

Sections 301.9100-1 through 301.9100-3 provide the standards the Commissioner will use to determine whether to grant an extension of time to make an election.

Section 301.9100-2 provides automatic extensions of time for making certain elections. Section 301.9100-3 provides extensions of time for making elections that do not meet the requirements of § 301.9100-2.

## CONCLUSION

Based solely on the facts and representations submitted, we conclude that X's S corporation election terminated on Date 4, under § 1362(d)(2), because of the ownership of X stock by Trust 1, which ceased to be an eligible S corporation shareholder at the end of the two-year period described in § 1361(c)(2)(A)(iii). We also conclude that, had X's S corporation election not terminated on Date 4, it would have terminated on Date 6, under § 1362(d)(2), because of the ownership of X stock by Trust 2, which also ceased to be an eligible S corporation shareholder at the end of the two-year period described in § 1361(c)(2)(A)(iii). We further conclude that the termination of X's S election was inadvertent within the meaning of § 1362(f).

Accordingly, pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from Date 4 and thereafter, provided X's S corporation election was valid and was not otherwise terminated under § 1362(d).

We also conclude that the requirements of § 301.9100-3 have been satisfied. Accordingly, B is granted an extension of time for 60 days from the date of this letter to file a QSST election for Trust 1 effective Date 3 and D is granted an extension of time for 60 days from the date of this letter to file a QSST election for Trust 2 effective Date 5. A copy of this letter should be attached to the QSST election. A copy is provided for that purpose.

This ruling is contingent on X and all its shareholders treating X as having been an S corporation for the period beginning on Date 4, and thereafter. The shareholders of X must include their pro rata share of the separately stated and nonseparately computed items of X as provided in § 1366, make any adjustments to basis provided in § 1367, and take into account any distributions made by X as provided in § 1368. If X or X's shareholders fail to treat X as described above, this ruling shall be null and void.

Except as specifically ruled above, we express no opinion concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, no opinion is expressed on whether X is otherwise eligible to be treated as an S corporation or whether either Trust 1 or Trust 2 is eligible to be treated as a QSST under § 1361(d)(3).

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the X's authorized representative.

Sincerely,

William P. O'Shea  
Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosures (2):  
Copy of this letter  
Copy for section 6110 purposes